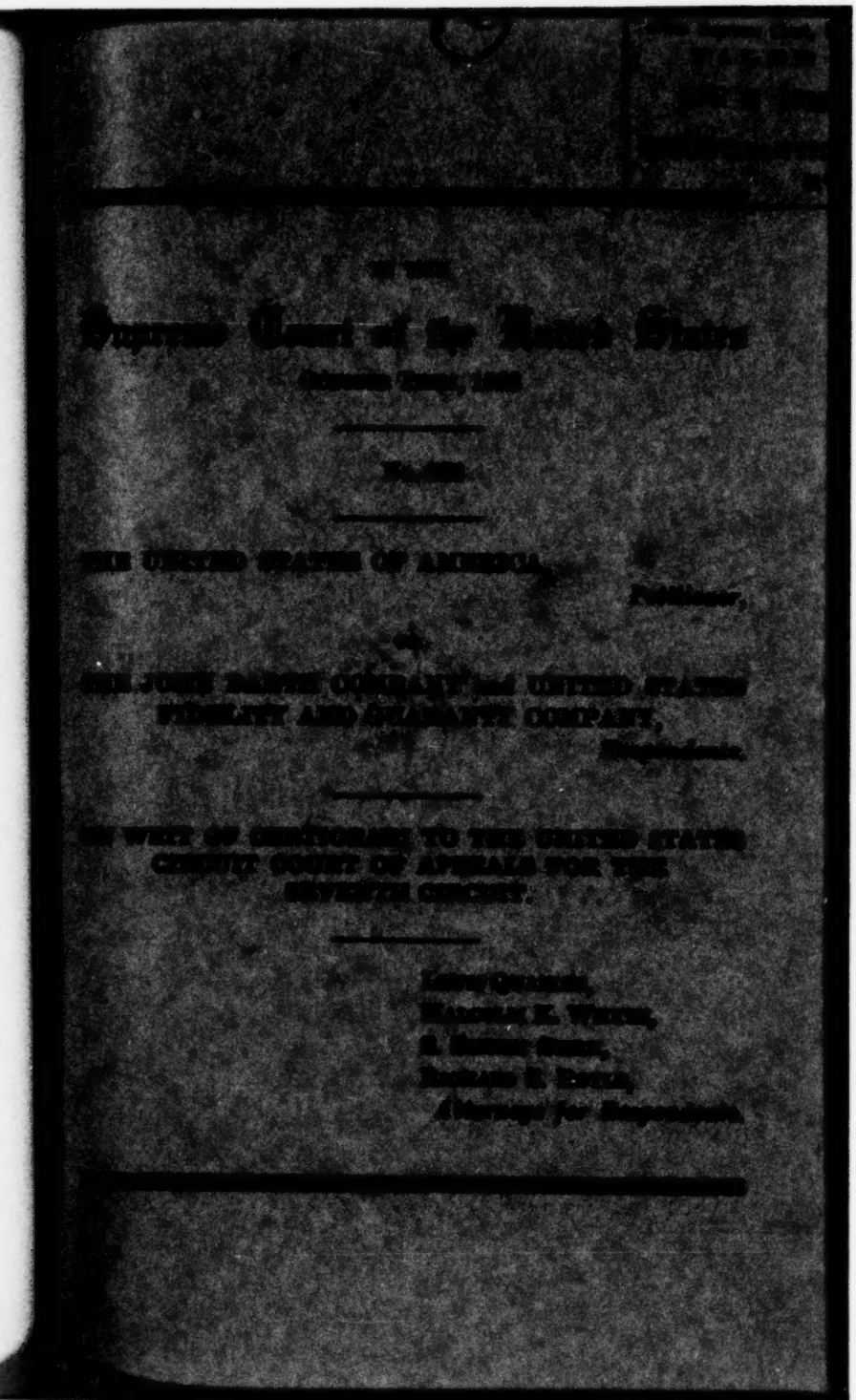


INDEX

PAGE

PRELIMINARY STATEMENT 1

THE ISSUE 3

SUMMARY OF ARGUMENT 4

ARGUMENT 6

CHAPTER I

The obligation under the bond is measured by the tax liability of the John Barth Company. No cause of action has ever arisen on the bond because no tax was determined to be due within five years after the return was filed 6

(a) The liability of the respondents must be determined from the terms of their written contract 6

(b) The language of the bond contemplates that before liability can attach under it, the commissioner must have determined a "tax" in accordance with the provisions of the Revenue Acts 10

(c) The decision of the Commissioner on the claim in abatement is a determination which is expressly barred by Section 250 (d) unless made within five years after the filing of the return 16

CHAPTER II

The liability on a bond is discharged when the primary debt of the principal secured thereby is extinguished. Here the primary debt (the tax liability) was extinguished before the commissioner purported to find any tax to be due 20

(a) The liability of a surety is dependent on the existence of a principal debt 20

PAGE

(b) The primary obligation in this case was only a limited right and was extinguished by the statute of limitations 21

(c) That the tax liability was extinguished by running of the statutory period also appears from the provisions of Section 1106 (a) of the Revenue Act of 1926.... 24

CHAPTER III

Comments upon the contentions set forth in the brief of the government 27

(a) The government has mistaken the issue... 27

(b) The Circuit Court of Appeals was correct in holding that the filing of the bond was not a waiver or tolling of the limitation provisions 28

(1) The Internal Revenue Bureau did not construe the filing of a claim in abatement as a waiver 28

(2) The Commissioner was not stayed as to the determination and hence not as to the collection of the tax 29

(3) Section 250 (d) and Section 234 (a) (14) (a) do not require a construction extending the statutory period 31

(4) The filing of the second claim in abatement after the running of the statute of limitation was ineffectual 34

(c) The cases cited by the Government are distinguishable 35

(d) The petitioner's brief is unsound in attempting to construe Section 234 (a) and 250 (d) of the Revenue Act of 1918 by considering statutes enacted by Congresses 8 and 10 years later 38

PAGE

(e) The principle that the United States is not to be bound by a statute of limitations unless such intention is clearly manifested is not applicable here 39

(f) The retroactive repeal of Section 1106 (a) of the Revenue Act of 1926 does not affect this action 40

(g) The petitioner has completely eliminated the word "determination" from Section 250 (d) of the Revenue Acts of 1918 and 1921 42

CONCLUSION 44

APPENDIX 45

PAGE

CASES CITED.

American Powder Mills vs. Commissioner, 12 B. T. A. 305 29
Amy vs. City of Watertown, 130 U. S. 320; 32 L. Ed. 953 30
Anderson vs. Commissioner, 15 B. T. A. 475 29
Appeal of New York Trust Co., 3 B. T. A. 583 18
Appeal of Ocean Accident & Guaranty Corp., 6 B. T. A. 1045 29
Appeal of Terminal Wine Co., 1 B. T. A. 697 17
Atlantic Coast Line vs. Burnette, 239 U. S. 199, 60 L. Ed. 226 24
Bauserman vs. Blunt, 147 U. S. 647, 37 L. Ed. 316, 320.. 30
Blair vs. Oesterlein Machine Co., 275 U. S. 220, 48 S. Ct. 87, 27 L. Ed. 249 13
Bogart vs. George K. Porter Co., 193 Cal. 197; 223 Pac. 959 31
Bowers vs. N. Y. & Albany Lighterage Co., 273 U. S. 346; 47 Sup. Ct. 389; 71 L. Ed. 676 ..... 18, 33, 39
Bowers vs. American Surety Co., C. C. A. 2nd Cir., 30 Fed. (2d) 244 10
Central Vermont R. Co. vs. White, 238 U. S. 507 23
Citizens Bank of LaFourche vs. Miller-Link Lbr. Co., 16 Fed. (2d) 163 22
Davis vs. Miller, 194 U. S. 453, 48 L. Ed. 1067 23
Dobbins vs. Commissioner, Prentice-Hall Federal Tax Service for 1929, Par. 603 41
Edward P. Mertz vs. Andrew Mellon, Sec. of Treasury, Prentice-Hall Federal Tax Service for 1928, p. 309.. 24
Gages Executors vs. Cassidy, 23 How. 109; 16 L. Ed. 430 20
Galveston H. & S. A. Ry. Co. vs. Webster Co., 27 Fed. (2d) 765 ..... 21, 23
Gile vs. Huntley, 29 Fed. (2d) 209 41
Gould vs. Gould, 245 U. S. 151, 62 L. Ed. 211 33

PAGE

Gove vs. Nichols, (D. C., Mass.) 23 Fed. (2d) 856..... 24
Gray Motor Co. vs. United States, 16 Fed. (2d) 367... 15
Joy Floral Co. vs. Commissioner of Internal Revenue, 29 Fed. (2d) 865 .....26, 35
Klein vs. Commissioner, 6 B. T. A. 617 29
Lieber vs. Commissioner, 13 B. T. A. 1175 29
Litchfield vs. McDonald, 35 Minn. 167, 28 N. W. 191... 31
McCaughn vs. Philadelphia Barge Co., 27 Fed. (2d) (E. D. of Pa.) 628 36
Merriam vs. U. S., 263 U. S. 179, 68 L. Ed. 240..... 33
Peerless Woolen Mills vs. Rose, Com. of Int. Rev. 28 Fed. (2d) 661 14
People vs. McGee, 41 Cal. App. 727, 183 Pac. 289..... 31
Raymond vs. U. S., Fed. Case 11596 38
Russell vs. U. S., 49 S. Ct. 121, 123 39
Shaffer vs. Commissioner, 12 B. T. A. 298 29
The Harrisburg, 119 U. S. 199; 30 L. Ed. 358..... 22
U. S. vs. Alexander, 110 U. S. 325; 28 L. Ed. 166..... 21
U. S. vs. Arredondo, 6 Pet. 725; 8 U. S. (L. Ed.) 547.... 33
U. S. vs. Chouteau, 102 U. S. 603; 26 L. Ed. 246..... 21
U. S. vs. Gillis, 95 U. S. 407; 24 L. Ed. 503..... 39
U. S. vs. John Barth, 27 Fed. (2nd) 782 ..... 2, 9
U. S. vs. John Barth, 276 U. S. 606 2
U. S. vs. Onken Bros. Co. Inc., 23 Fed. (2d) (Wyo.) 367 35
U. S. vs. Reynolds, 27 Fed. (2d) 902 .....35, 36
U. S. vs. Rindskopf, 105 U. S. 418; 26 L. Ed. 1131..... 15
U. S. vs. U. S. Fidelity & Guaranty Co., 221 Fed. 27... 38
Veach vs. Rice, 131 U. S. 293; 33 L. Ed. 163..... 20
Walsh vs. Price (E. D. of N. Y.) C. C. H., 1929 Vol. III, p. 8072 35
Weston vs. Jones, 160 Minn. 32; 199 N. W. 431..... 31
William Danzer & Co. vs. Gulf & Ship Island Ry. Co., 268 U. S. 633, 69 L. Ed. 1126 .....23, 40

PAGE

Williamsport Wire Rope Co. vs. U. S., 277 U. S. 551, 48 Sup. Ct. 140, 72 L. Ed. 985 14
Wirt, Franklin vs. Commissioner, 7 B. T. A. 636 29

LEGISLATION CITED.

Revenue Act of 1918, c. 18, 40 Stat. 1047
Sec. 234 (a) (14) (a) 2, 3, 7, 8, 10, 13, 32
Sec. 250 (d) 3, 4, 43
Revenue Act of 1921, c. 136, 42 Stat. 227
Sec. 250 (d) 3, 4, 16, 32
Revenue Act of 1926, c. 27, 44 Stat. 9
Sec. 1106 (a) 3, 5, 6, 24
Sec. 274 (a) 13
Sec. 283 (c) 13
Revenue Act of 1928, c. 852, 45 Stat. 791
Sec. 612 ..... 3, 6, 40

MISCELLANEOUS.

Law Opinion 1095 of Solicitor of Internal Revenue, Pub. in C. B. I—1 (1922) p. 314 11
Regulations 45, Art. 1032 (Revenue Act of 1918) 28
Williston on Contracts, Vol. 2, Par. 1213 8
37 Corpus Juris 686 24

IN THE

Supreme Court of the United States

OCTOBER TERM, 1928

No. 526

THE UNITED STATES OF AMERICA,

Petitioner,

vs.

THE JOHN BARTH COMPANY and UNITED STATES FIDELITY AND GUARANTY COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENTS, THE JOHN BARTH COMPANY, AND THE UNITED STATES FIDELITY AND GUARANTY COMPANY

PRELIMINARY STATEMENT

The facts are presented in the brief on behalf of the United States, and we shall make only a brief resumé. The controlling statutes are set out in an appendix to this brief.

On May 15, 1919, The John Barth Company filed its income and excess profits tax return for the calender year

1918. The Revenue Act of 1918, in Section 234 (a) (11) (a) provided that a taxpayer could file a claim in abatement based on the fact that it had sustained a substantial loss resulting from any material reduction of the value of its inventory for such taxable year. Pursuant to this section of the Revenue Act of 1918, The John Barth Company filed its claim in abatement, and on September 20, 1919, a bond (R. 3-4) executed by The John Barth Company, as principal, and the United States Fidelity & Guaranty Company, as surety, was filed with the Collector of Internal Revenue, at Milwaukee, Wisconsin. The bond was conditioned upon payment, duly made by the principal, of such tax found by the Commissioner to be due, with interest, etc. On March 25, 1926, more than six years after the return was filed, the Commissioner of Internal Revenue purported to make a determination that a portion of the tax involved was due. The principal, after notice and demand, refused to pay the amount so found, whereupon this action was begun on the bond on September 22, 1926, seven years after the date of the filing of the taxpayer's income tax return, upon a determination made more than six years after the claim in abatement and bond were filed.

The District Court sustained a demurrer to the complaint and the case was certified to this court by the Circuit Court of Appeals for the Seventh Circuit, but was remanded with instructions that such proceedings be had as according to right and justice and the laws of the United States ought to be had. (276 U. S. 606, R. 15) On June 7, 1928, the Circuit Court of Appeals filed its opinion sustaining the decision of the District Court and denied rehearing September 12, 1928. (27 Fed. (2d) 782, R. 16-21). The case now comes before this court pursuant to the granting of a petition for a writ of certiorari from this court to the United States Circuit Court of Appeals for the Seventh Circuit. (R. 21)

The Revenue Act of 1918, Section 250 (d), provides that no determination or assessment shall be made and no suit or proceeding shall be begun for the collection of a tax under that Act after the expiration of five years from the date of filing the return, in this case, May 15, 1919.

The Revenue Act of 1921, Section 250 (d), is practically the same and refers to returns made under prior acts which would include the Revenue Act of 1918.

The Revenue Act of 1926 (February 26, 1926), Section 1106 (a), provided that the bar of the statute of limitations against the United States in respect of any internal revenue tax shall not only bar the remedy but shall extinguish the liability.

Section 612 of the Revenue Act of 1928 repealed Section 1106 (a) of the Revenue Act of 1926 as of February 26, 1926.

THE ISSUE

The statement of the question presented, appearing on page 2 of the petitioner's brief, is respectfully submitted to be incorrect and misleading. A proper statement of the issue involved is as follows:

> May an action on a bond given under Section 234 (a) (14) (a) of the Revenue Act of 1918 "conditioned for the payment of any part of *such tax* found by the Commissioner to be due" be maintained when the Commissioner made no determination and found no tax to be due until after the running of the statutory period of limitation of the Revenue Acts within which determinations must be made? (Italics ours.)

The distinguishing feature of this case, which must not be lost sight of, is that the Commissioner of Internal Revenue made no determination of any tax nor found any tax to be due until after the period of limitation provided for in the

Revenue Acts had elapsed. The real issue in this case is not whether the statutes of limitation applicable to the tax liability are applicable to the suit on the bond as statutes of limitation. The issue is whether the discharge of the tax liability by operation of those statutes did not discharge the obligors on the bond from liability under their contract.

SUMMARY OF ARGUMENT

The liability of the respondents must be determined from the terms of their written contract, to wit: the bond. The primary obligation under the bond was the tax liability of the John Barth Company by which the obligation on the bond is to be measured. The bond was not drawn to pay a fixed sum or render a stated performance or to pay any amounts that remained "unpaid" but was an agreement to pay "such tax found by the Commissioner to be due," and required that there be "notice and demand by the collector." This language contemplates that the Commissioner in determining the "tax" must do so in accordance with the provisions of the Revenue Acts. The word "due" implies that the tax at the time of the determination must be then enforceable. The Commissioner in his determinations is bound by all of the revenue laws of the United States, including limitation provisions. The decision of the Commissioner on the claim in abatement was a determination expressly barred by Section 250 (d) of the Revenue Acts of 1918 and 1921, unless made within five (5) years after the filing of the return.

The Government's case rests upon ignoring the limitation in Section 250 (d) of the Revenue Acts of 1918 and 1921 upon the power of the Commissioner to determine the tax (Government's Brief pages 9-10). The pro forma assessment made on June 25, 1919, was not a determination either under the language of the statutes nor under the language of

the bond which obviously referred to a determination to be made subsequent to the delivery of the bond.

It is well established that the liability of a surety is dependent on the existence of the principal debt at least when the bond is conditioned to pay the debt. In this case the principal debt was a tax liability. The Revenue Act of 1918 created the tax liability and fixed the period within which such liability could exist. On the expiration of the limitation period, the tax liability was extinguished in accordance with the general rule applicable to a liability limited by the statute creating it. Moreover, Section 1106 (a) of the Revenue Act of 1926 expressly provided that when a statute of limitations has run against the government, it should "not only operate to bar the remedy, but shall extinguish the liability." The determination was made after the expiration of the statutory period and the enactment of section 1106 (a) and hence was of no effect.

The filing of the bond did not constitute a waiver by the taxpayer of the limitation provisions. The Government's hand was not stayed and it could pursue its remedy at any time it chose to make its decision upon the claim in abatement. The language of the statute does not expressly extend the limitation period when a claim in abatement is filed, nor is there any language reasonably calling for such construction. The purpose of the bond was to give additional security during the time that the Commissioner might take to make his determination within the statutory period rather than to give the Commissioner both additional security and unlimited time.

Cases in which the determination was made *before* the expiration of the limitation period, thereby giving a cause of action on the bond, are not in point. Furthermore, the retroactive repeal of section 1106 (a) of the Revenue Act of

1926, which was merely a declaratory statute, did not purport to affect and did not affect the operation of section 250 (d) of the Revenue Acts of 1918 and 1921 by force of which the tax liability of the respondents was extinguished prior to any determination by the Commissioner of Internal Revenue. In case the repeal of section 1106 (a) by section 612 of the Revenue Act of 1928 be construed to recreate the respondents' liability on their contract of suretyship, which had once been extinguished, it is clearly unconstitutional in that it deprives them of their vested rights, contrary to the Fifth Amendment.

The limitation provisions of the Revenue Acts having operated to destroy the tax liability, which formed the obligation of the bond, before a cause of action on the bond ever arose, no action on the bond is now maintainable.

ARGUMENT.

CHAPTER I.

THE OBLIGATION UNDER THE BOND IS MEASURED BY THE TAX LIABILITY OF THE JOHN BARTH COMPANY. NO CAUSE OF ACTION HAS EVER ARISEN ON THE BOND BECAUSE NO TAX WAS DETERMINED TO BE DUE WITHIN FIVE YEARS AFTER THE RETURN WAS FILED.

(a) *The liability of the respondents must be determined from the terms of their written contract.*

The obligation under the bond is measured by the tax liability of The John Barth Company. The Government throughout its brief takes the position that the liability of The John Barth Company for income tax is immaterial in

this action brought by the Government on the bond. This action is one based upon a written obligation and in determining the rights of the parties thereto it is necessary to examine the terms of the written instrument. The bond by its terms provides that it is given pursuant to Section 234 (a) (14) (a) of the Revenue Act of 1918. That section of the Revenue Act provides that at the time of filing the return for the taxable year 1918 a taxpayer might file a claim in abatement based on the fact that he had sustained a substantial loss resulting from a material reduction of the value of his inventory for the taxable year 1918 or from the actual payment in 1919 of rebates in pursuance of contracts entered into during the year 1918 upon sales made in 1918. A bond given pursuant to this section of the statutes contemplated that information obtained in the year 1919 might be used in readjusting the value of 1918 inventories and that rebates paid in 1919 might be credited to the taxpayer in computing his 1918 income tax. Inasmuch as the information in question could not be obtained until after the close of the taxable year, Congress provided in Section 234 (a) (14) (a) that, upon the filing of a claim in abatement and a bond, payment of the amount of tax involved in the claim would not be required until the claim was decided. The rule of self assessment and of immediate payment was done away with by Congress in this class of cases. Under this statute there was no duty on the taxpayer to make payment of the amount of the claim until his loss on a war inventory was determined if only the taxpayer would protect the Government from his intervening insolvency by filing a bond as security.

The question of what constitutes the taxable income of the taxpayer is definitely presented to the Commissioner for determination by the filing of both the return and the claim in abatement. Under the statute the net amount disclosed by the return and claim in abatement may quite as fairly be

considered the true taxable income of the taxpayer as the larger amount disclosed in the return alone. In fact it is submitted that the two documents should be considered together as constituting the return. In any event the taxpayer, having paid the net amount disclosed by the return and claim in abatement, has discharged his entire present statutory tax obligation and owes no further obligation until and unless the Commissioner shall later determine that an additional amount is due.

The respondents filed a bond (R. 34) such as was contemplated by Section 234 (a) (14) (a) of the Revenue Act of 1918 by the terms of which the taxpayer, as principal, and the United States Fidelity & Guaranty Company, as surety, agreed to pay $60,000.00 on condition that the agreement should be null and void if the principal, on notice and demand by the Collector, duly paid "any part of such tax found by the Commissioner to be due," with interest, etc. The language of the bond follows the language of the statute.

The obligation of the bond was to pay the existing tax liability of The John Barth Company when and if duly determined by the Commissioner. Bondsmen may agree that a certain definite fixed performance shall be rendered by them, or, on the other hand, they may merely undertake to pay whatever the principal is legally obligated to pay. These two undertakings are entirely different and the failure to appreciate this distinction appears throughout the petitioner's argument. The distinction has been very ably discussed by Professor Williston in his work on Contracts, Volume 2, paragraph 1213:

> "It is often said that the surety is not liable unless the principal is bound, but that this rule is subject to many exceptions. Such a statement omits an essential primary inquiry, namely, what are the terms of the con-

tract? It is possible for a surety to promise to pay whatever debt the principal may owe. On the other hand, the surety's promise may be to pay a stated sum or render a fixed performance for which the principal also purports to bind himself. If the contract is of the former sort it is obvious that by the very terms of his contract the surety is liable for nothing if the principal is under no liability; and statements not infrequently made that a surety cannot be liable unless a principal debtor is liable have reference to such case and must be confined to it. On a fair interpretation where the surety's promise relates to a specific transaction, it will generally be found that his promise must be construed as one to pay an agreed sum or to perform a duty fixed by some other standard than the obligation which the principal debtor may be under. On the other hand, where a surety makes a general promise to answer for such debts or obligations as the principal may be liable for in a certain business or series of transactions, he is likely to define the obligations for which he himself will be answerable as such debts or obligations as the principal debtor may be bound to discharge. The latter class of cases then offer no other difficulty than to determine whether the principal debtor is under any obligation, and attention must be directed to the former class."

We are dealing with a bond under Professor Williston's first group, namely, an obligation "to pay whatever debt the principal may owe," and accordingly the obligation of the bond is to be measured by the liability of The John Barth Company for taxes.

The importance of considering the exact language of the surety contract before entering upon generalizations as to the effect of surety bonds, is emphasized by the decision of the Circuit Court of Appeals in this case where it says:

"Inasmuch as the parties agreed to pay 'any part of such *tax* found by the Commissioner to be due' there

was no obligation to pay what had been *extinguished* prior to the commencement of this action.

"This distinction may at first seem to be a refined one, but it is predicated upon the rule that the surety is justified in construing his contract strictly.

"That the parties might have agreed to pay a sum of money rather than a tax cannot be questioned. Likewise they had the option of submitting an agreement where the liability was limited to the payment of a *tax*. In the agreement under consideration, defendants agreed merely to pay the tax. The tax having been extinguished, the government cannot enlarge by construction of words, or otherwise, the obligation of the parties." (R. 18)

In the recent case of *Bowers vs. American Surety Company*, (C. C. A. 2nd Circ.) 30 Fed. (2d) 244, the bond provided that the surety would pay so much of an additional assessment as remained unpaid. The court indicated very clearly that if the bond had been only for such amount as might be "due", a different question would be involved and said:

"The condition was not that the L. C. Blancke Company should pay the tax due, but the tax assessed so far as the Commissioner should not abate it within the year."

(b) ***The language of the bond contemplates that before liability can attach under it, the commissioner must have determined a "tax" in accordance with the provisions of the Revenue Acts.***

The language of the bond follows the language prescribed by the statute (Section 234 (a) (14) (a), Revenue Act of 1918), and provides that:

"The condition of the foregoing obligation is such that if the principal shall on notice and demand by the collector, duly pay any part of such tax found by the

> commissioner to be due with interest * * * and shall otherwise well and truly perform and observe all of the provisions of law and the regulations, then this obligation is to be void, but otherwise to remain in full force and virtue."

The court's attention is invited to the fact that the bond stipulates for "notice and demand by the collector" on the principal (the taxpayer). In other words it contemplates that when the Commissioner has made his finding, such finding shall be reduced to the form of a tax assessment and be demanded by the collector in the usual manner which obviously must be within the statutory period. It will further be noted that the expression used is "such tax" as is "found by the commissioner to be due". Do not these words clearly require that at the time the Commissioner determines "such tax" he must take into account whether or not the sum in question is still "due" as a "tax" or whether a statute of limitations has run on it? To hold otherwise would seem to make the words "to be due" meaningless. The Internal Revenue Department itself has construed the word "due" when used in tax statutes as implying that the statute of limitations has not run. We refer to Law Opinion No. 1095 of the Solicitor of Internal Revenue published in C. B. I-1, (1922), page 314, where the Solicitor says:

> "It is believed, however, that the expression 'then due' as contained in Section 252 (Revenue Act of 1921), is used in a more restricted sense than simply 'owing' and has reference to an enforceable claim on the part of the government."

We submit, therefore, that when the Commissioner determines the claim of abatement, he must first, under the terms of the bond, reduce his determination to the form of a tax, give notice and make demand for the tax in the manner provided in the Revenue Act for taxes; and in making his deter-

mination he is governed by all the law applicable to taxes, including statutes of limitation. Failing in this the Commissioner can claim no rights under the bond.

The Government's contention seems to carry with it a very obvious fallacy. It amounts to this: That the Commissioner in determining the tax may disregard the fact that The John Barth Company is not liable for any tax. This seems in itself to be a contradiction in terms. Either the Commissioner in his determination must be controlled by the law, or he is free from any control in making his determination. If he is under no obligation to respect the limitation provisions, Section 250 (d) of the Revenue Act of 1921 and Section 1106 (a) of the Revenue Act of 1926, in making his determination, is he under any obligation to respect any other requirement of the law? Could he have assessed a tax in the amount of a million dollars in the instant case on a total net income of much less than that amount? Could he have determined it at twice the statutory rates? Could he have determined the tax although his record showed that it had been paid by the taxpayer? If the tax were "extinguished" in some other manner, beside payment, could he still "determine" it to be due? Could he defer the determination of the tax for fifty years and then proceed at his pleasure claiming that the liability did not attach on the bond and the statute of limitations start to run until 1969? Obviously the Commissioner, under the terms of the bond, could not proceed arbitrarily. This bond, conditioned in statutory terms, did not confer unlimited and unrestrained authority on the Commissioner to determine its obligation. He was bound by the Internal Revenue law. If he was bound by any of it, he was bound by all of it.

The theory of the Government that the Commissioner in determining any claim of abatement where a bond is filed need not be controlled by the law governing tax liability

would repose in him power such as Congress certainly never contemplated and such as no one has heretofore imagined. When Congress passed Section 234 (a) (14) (a) of the Revenue Act of 1918, which provided that the bond should be "conditioned for the payment of any part of such tax found to be due" by the Commissioner, it certainly meant that such finding must be in accordance with law.

Congress did not intend to exact as a price for proceeding under Section 234 (a) (14) (a) a solemn promise under seal to pay any determination made by the commissioner, legal or illegal. This court has not looked with favor upon any construction of the revenue statutes which seeks to repose arbitrary and uncontrolled discretion in the Commissioner of Internal Revenue. In the very recent case of *Blair vs. Oesterlein Machine Company*, 275 U. S. 220, 48 S. Ct. 87, 72 L. ed. 24, the claim was advanced that under the special assessment provisions of Sections 327 and 328 of the Revenue Act of 1918, the Commissioner's determination of the proper comparatives to be used was not subject to review. This court held that there was no basis for such an unreasonable construction of the statute and could find no justification for "the supposedly sacrosanct character of his determination under paragraphs 327 and 328." We do not think that the court in the instant case should look with any more favor on the claim now advanced by the Government for another type of "sacrosanct" determination.

The fallacy that the determination of the Commissioner provided for in the bond may mean an arbitrary determination made by him rather than a determination under the statutes, is demonstrated by considering the effect of the sections of the Internal Revenue acts now providing for appeals to the Board of Tax Appeals. Under the provisions of Section 274 (a) and 283 (c) Revenue Act of 1926, (set forth in the appendix), a taxpayer has a right to appeal to the Board

of Tax Appeals from any determination of a deficiency by the Commissioner. Let us assume that in the instant case the taxpayer had filed an appeal to the Board of Tax Appeals, which he could do as the determination of the tax liability was made after the passage of the 1926 Revenue Act. In such event the Board of Tax Appeals would have complete jurisdiction over the additional tax, penalty and interest as well as the tax shown on the original return, and over-payments, if any. *Peerless Woolen Mills vs. Rose, Collector of Internal Revenue*, 28 Fed. (2d) 661; *Williamsport Wire Rope Co. vs. U. S.* 277 U. S. 551; 48 Sup. Ct. 140; 72 L. ed. 985. It is very clear under the above cases that the full administrative consideration of the tax and hence the final determination of the Commissioner is not complete until the review by the Board of Tax Appeals.

Let us assume in the instant case that such an appeal had been taken and that the Board of Tax Appeals had reversed the Commissioner's determination and found that the claims in abatement should have been allowed. Could the Commissioner in such event nevertheless sue on the bond claiming that he had determined the tax to be due and that he had a cause of action under it? Would it not be anomalous to hold that bondsmen should be compelled to pay taxes which the Board of Tax Appeals had decided under the laws were never due or owing and which found their justification only in errors of the Commissioner?

We submit therefore that the bond in this case was given for the purpose of securing the payment of such tax as the Commissioner might lawfully determine was owing to the United States by The John Barth Company. It appears to us to be clear from the terms of the bond itself, that the obligation of the surety was measured by the tax liability of The John Barth Company and that unless the Commissioner of Internal Revenue *lawfully* determined that a tax was due,

there could be no breach of the bond. To hold otherwise would be to require the surety to agree to pay the amount of money determined by the Commissioner to be due as a tax without regard to the existence of any tax liability on the part of the principal.

The petitioner in its brief seems to argue that a taxpayer and surety in signing a bond are barring themselves completely from asserting defences based on the validity of the tax determination. The argument seems to be implied that the moment such an undertaking is entered into the taxpayer and his surety are no longer interested in the merits of the tax controversy under consideration, but are completely subject to the arbitrary caprice of the Commissioner in making his determination. This argument goes too far. It appears to take away from a surety bond conditioned to pay a tax the ordinary character of a bond and convert it into a type of blank check or demand judgment note.

There is one case that appears to go to such extent. That case is *Gray Motor Co. vs. United States*, 16 Fed. (2d) 367, cited on pages 19 and 20 of the Government's brief. The doctrine of that case, we submit, is not only poorly reasoned but is obviously dictum as the court found that the statute of limitation had not in fact run. In addition, it is the settled law in this court that in an action on a bond to pay a tax, the surety can introduce defences on the merits to show that the particular tax was not owed. *U. S. vs. Rindskopf*, 105 U. S. 418; 26 L. ed. 1131.

In the instant case, therefore, no cause of action has ever arisen on the bond because no tax was determined to be due at a time when the Commissioner had lawful authority to determine any tax liability. The return of The John Barth Company was filed May 15, 1919, and the bond in question filed September 20, 1919, but not until March 25, 1926, did the

Commissioner purport to make a determination of the tax due from The John Barth Company.

(c) *The decision of the Commissioner on the claim in abatement is a determination which is expressly barred by Section* 250 (d) *unless made within five years after the filing of the return.*

Section 250 (d) of the Revenue Act of 1921 (c. 136, 42 Stat. 227, 265) provides that:

> " * * * the amount of any such taxes due under any return made under this act for prior taxable years or under prior income, excess profits, or war profits tax acts * * * shall be *determined* and assessed within five years after the return was filed. * * * " (Italics ours).

The phrase in the bond "found by the Commissioner to be due" means "determined" by the Commissioner to be due *within the limit of time fixed by the Revenue Act itself.* His purported determination after that time is contrary to law and of no effect.

The original assessment on June 25, 1919, by the Commissioner of a tax in the sum disclosed by the original return as filed is not material in this connection. That assessment did not involve the determination of an issue but was based upon the information disclosed by the return. It is the "self-assessment" which is a well known feature of federal income taxation. It is a purely ministerial posting of the amount shown on the taxpayer's return and is in no sense an administrative determination. No opportunity arose for the making of any "determination" until the claim for abatement had been filed. Then, for the first time, an issue was raised between the taxpayer and the Government calling for a "determination" by the Commissioner. Such construction of the term "determination" finds able support in the well considered decision by the Board of Tax Appeals in the *Ap-*

peal of Terminal Wine Co., 1. B. T. A. 697, decided February 28, 1925, an excerpt of which is set out below.

> "The *determination* from which a taxpayer may appeal is one which fixes the amount of *deficiency* in tax. It is the final decision by which the controversy as to the deficiency is settled and terminated, and by which a final conclusion is reached relative thereto and the extent and measure of the deficiency defined. *An assessment* made without compliance with the statutory remedy of appeal contained in section 250 (d) of the Revenue Act of 1921, and against which a claim for abatement is received for consideration by the Commissioner, does not meet the definition of a determination above given. The listing of an assessment followed by a notice to the taxpayer that an abatement claim will be received and the correctness of the amount of the tax later settled on the merits of the controversy (or the acceptance of such a claim for consideration without such notice) effectually refutes the idea that the assessment is a *determination* as above defined. The statute, for the purpose of protecting the public revenue, authorizes the Commissioner under certain circumstances to assess taxes without benefit to the taxpayer of his statutory right to a determination prior to such assessment. Such assessments are familiarly referred to as *summary*, *jeopardy*, or *noncompliance* assessments. These terms are loosely used and frequently interchangeably, though strictly speaking they are not the same. However, in any such case, where the Commissioner so assesses a tax and thereafter accepts an abatement claim in which are set up the contentions of the taxpayer against the deficiency assessed, the issue between the taxpayer and the Commissioner is then set up and it is then that a controversy arises between the parties. It must be apparent that to hold that the assessment constitutes the determination, or presupposes (under these circumstances) a determination, is to hold that the issues are determined before they are raised and before the controversy arises. To so hold would necessarily deprive the taxpayer of a determi

nation *on the issues*. A controversy settled and decided before there is a controversy is not a controversy at all. As defined above a *determination* must be a settling of an existing controversy susceptible of consideration, decision, and conclusion—and a *termination* thereof. That which has not begun can not be terminated."

We also refer the court to *Appeal of New York Trust Co.* 3 B. T. A. 583, where court said:

> "The determination from which a taxpayer may appeal is one which fixes the amount of deficiency in tax. It is the final decision by which the controversy as to the deficiency is settled and terminated, and by which a final conclusion is reached relative thereto and the extent and measure of the deficiency defined. Appeal of Terminal Wine Company, supra, page 701. If, therefore, the determination made by the Commissioner is not the determination of a deficiency as defined by the statute, then jurisdiction does not obtain."

Any other construction of the limitation on the determination of the tax is inconsistent with the provision of the 1921 Act immediately following it:

> "The amount of any such taxes due under any return * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later *determination*, assessment and collection of the tax." (Italics ours).

In the words of a recent opinion of this Court in the case of *Bowers, Collector of Int. Rev. vs. New York & Albany Lighterage Co.*, 273 U. S. 346, 47 S. Ct. 389, 71 L. ed. 676,

> "A reasonable view of the matter is that it was the intention of Congress by the clause (Section 250 (d) here in question to protect taxpayers against any proceeding whatsoever for the collection of tax claims not made and pressed within five years."

We believe that the construction of Section 250 (d) laid

down in that case with regard to collection of taxes is equally and necessarily controlling with respect to the co-ordinate requirement of determination. This court there said, in referring to the Government's contention that Section 250 (d) did not bar a distraint proceeding:

> "Petitioner's construction of the limitation is inconsistent with the provision immediately preceding it. 'The amount of any such taxes due under any return * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and *collection* of the tax.' If collection by distraint were not barred by Section 250 (d) it would not be necessary to have this general consent of taxpayers that collection, as well as determination and assessment, might be made after the lapse of the prescribed period."

In other words, we submit that a condition precedent to the existence of a cause of action on the bond was never performed, namely, the lawful determination that a tax was due.

The power of the Commissioner to determine the tax liability of The John Barth Company under the Revenue Act of 1918 ceased on May 14, 1924, or five years after its return was filed. His inability thereafter to find "any tax to be due" rendered impossible the accrual of any cause of action on the bond.

CHAPTER II.

THE LIABILITY ON A BOND IS DISCHARGED WHEN THE PRIMARY DEBT OF THE PRINCIPAL SECURED THEREBY IS EXTINGUISHED. HERE THE PRIMARY DEBT (THE TAX LIABILITY) WAS EXTINGUISHED BEFORE THE COMMISSIONER PURPORTED TO FIND ANY TAX TO BE DUE.

(a) *The Liability of a Surety is Dependent on the Existence of a Principal Debt.*

The rule is firmly established that where the primary debt of the principal is extinguished, the liability on the bond given to secure the same ends.

We invite the court's attention to the leading case of *Gages Executors vs. Cassidy*, 23 How. 109; 16 L. Ed. 430. In this case an administrators' bond, executed by the two administrators and a surety, had been sued upon and judgment given against the surety in some $8,000. Subsequently in the proceedings before the Probate Court having jurisdiction of the estate, the liability of the administrators to the estate which had formerly been set at some $8,000 had been reduced to approximately $800. A proceeding was then started by the surety for the purpose of being relieved and this court allowed relief on the ground that the liability of the principals for the principal debt to the estate having been extinguished, at least in part, the surety's liability on the bond should be correspondingly extinguished, and said:

> "The natural limit of the obligation of a surety is to be found in the obligation of the principal; and when that is extinguished, the surety is, in general, liberated."

See also:

Veach vs. Rice, 131 U. S. 293; 33 L. Ed. 163;

U. S. vs. Chouteau, 102 U. S. 603; 26 L. Ed. 246;
U. S. vs. Alexander, 110 U. S. 325; 28 L. Ed. 166.

This general principle has recently been reaffirmed in a case analogous to the one here involved. In *Galveston H. & S. A. Ry. Co. vs. Webster Co.*, 27 Fed. (2d) 765, an action was brought on a bond to recover charges for freight in interstate commerce more than three years after the cause of action accrued and it was held that the action was barred by the three year statue of limitations set forth in the Interstate Commerce Act, Section 16, Subsection 3, as amended by the Transportation Act of 1920, Section 424. The decision in that case stated:

> "That statute provides something more than a limitation of the time within which suit is to be brought. By its terms, failure to sue within the time fixed absolutely destroys further right of action. There can be no saving exception accorded the surety by the local law. Principal and surety stand on the same footing in this case. The action is destroyed by the supreme law. The cause of action no longer exists against either principal or surety."

(b) *The Primary Obligation in this Case was only a Limited Right and was Extinguished by the Statute of Limitations.*

The primary tax liability here involved arose solely by virtue of the Revenue Act of 1918. That Act authorized the collection of taxes under certain circumstances, from certain individuals at certain rates provided it was done within a certain time. The same statute which gave and defined the right to collect, limited the time within which the tax must be determined and collected. In other words, it created a limited right, and a correlative limited liability. The same principle governs the limited liability imposed by the Revenue Laws, as governs the statutory liability created under

statutes similar to Lord Campbell's Act, the Employers' Liability Act, and others. The distinguishing characteristic of this type of liability is that the very statute which creates the liability limits the period in which that new liability may exist. In such cases bringing the action within the time provided by the statutes is a condition precedent to the existence of the liability itself. Such statutory provision is not, strictly speaking, a statute of limitation. It is a delimitation of the extent of the right itself, and therefore, when the period of time in question has run without action having been brought, the right itself and not merely the remedy has been extinguished. Thus we find it stated in the case of *The Harrisburg*, 119 U. S. 199; 30 L. Ed. 358, at page 362, that:

> "The statutes create a new legal liability, with the right to a suit for its enforcement, provided the suit is brought within twelve months, and not otherwise. The time within which the suit must be brought operates as a limitation of the liability itself as created, and not of the remedy alone. *It is a condition attached to the right to sue at all.*" (Italics ours).

We also respectfully refer the court to *Citizens Bank of LaFourche vs. Miller-Link Lbr. Co.*, 16 Fed. (2d) 163, in which it was said with reference to Section 250 (d) of the Revenue Act of 1921:

> "The language of the statute strikes me as being within itself conclusive of the question involved. The law that creates the right to collect the taxes by its terms, provides that no suit or proceeding for the collection of them shall be begun after the expiration of five years after the date when the return was filed. The claim becomes to all intents and purposes extinguished after that time. It is the policy of the government that claims after that lapse of time shall be uncollectible in court. This construction, as far as I have been cited to

cases and my own investigation extends, has been sustained by all the courts to which the question has been presented. *DuPont vs. Graham*, (D. C. 283, F. 300; *Seaman vs. Bowers*, (C. C. A.) 297, F. 371; *New York & Albany Lighterage Co. vs. Bowers*, (D. C.) 4 F. (2d) 604."

Davis vs. Mills, 194 U. S. 453, 48 L. Ed. 1067.
In this latter case the court said (page 454):

"It is true that this general proposition is qualified by the fact that the ordinary limitations of actions are treated as laws of procedure and as belonging to the lex fori, as affecting the remedy only and not the right. But in cases where it has been possible to escape from that qualification by a reasonable distinction courts have been willing to treat limitations of time as standing like other limitations and cutting down the defendant's liability wherever he is sued. The common case is where a statute creates a new liability and in the same section or in the same act limits the time within which it can be enforced, whether using words of condition or not."

In a recent decision of this court in *William Danzer & Co. vs. Gulf & Ship Island Ry. Co.*, 268 U. S. 633; 69 L. Ed. 1126, this court said with respect of running of the statutory limitations:

"But such provisions sometimes constitute a part of the definition of a cause of action created by the same or another provision, and operate as a limitation upon liability. Such, for example, are statutory causes of action for death by wrongful act (cases cited), and those arising under the *Federal Employers' Liability Act* * * *" (Cases Cited).

See also to the same effect:

Central Vermont R. Co. vs. White, 238 U. S. 507, at 511, 59 L. Ed. 1433, 1436

Galveston H. & S. A. Ry. Co. vs. Webster Co., 27 Fed. (2d) 765.

Goce vs. Nichols, (D. C., Mass.) 23 Fed. (2d) 856.

Atlantic Coast Line vs. Burnette, 239 U. S. 199, 60 L. Ed. 226.

37 Corpus Juris 686.

(c) *That the Tax Liability was Extinguished by Running of the Statutory Period also Appears from the Provisions of Section* 1106 (a) *of the Revenue Act of* 1926.

Section 1106 (a) of the Revenue Act of 1926, 44 Stat. 113, reads:

> "The bar of the statute of limitations against the United States in respect of any Internal Revenue tax shall not only operate to bar the remedy but shall extinguish the liability. * * * "

It has already been demonstrated in the previous chapter that the statutory period of five years provided by Section 250 (d) of the Revenue Act of 1918 barred assessment, determination, and collection of any tax. It is apparent, therefore, that the bar of the statute of limitations had operated at least against the remedies, and the express provisions of section 1106 (a) declaring that the liability is in such event extinguished, are applicable at least after February 26, 1926.

The word "extinguish" as used in Section 1106 (a) is certainly as broad as any that could be found to indicate the intent of the Congress. It is difficult for the mind to conceive of language any more emphatic than is here used.

The Government argues in its brief, pages 30-35, that Section 1106 (a) should be construed as limited in its application by reason of the fact that it was passed to relieve taxpayers from whom the Internal Revenue Bureau had wrongfully exacted taxes after the statute of limitations had run, and that its sole function is in cases where the taxpayer is bringing an action against the Government to recover such

W. v. Mo. Co. No. 19. Oct. Term
Subacco

wrongfully exacted taxes. We do not think that the section can be given such a narrow construction. Its language is sweeping. The Revenue Law of 1926 took effect on February 26, 1926, one month before the Commissioner passed upon the claim in abatement and purported to determine the tax due. At that time the amount of tax due from the John Barth Company under its return had not been determined by the Commissioner, although more than five and nearly seven years had elapsed since the return was made. Furthermore, no suit or proceeding for the collection of the tax had been begun.

By Section 1106 (a) of the Act of 1926, the five year limitation, provided by Section 250 (d) of the Revenue Act of 1918, on the power of the Commissioner to determine and assess the tax and to institute suits or proceedings for its collection had operated to extinguish all tax liability. A limitation statute which operates to bar only the remedy is a mere procedural statute. A limitation statute, however, which operates not only to bar the remedy, but also to extinguish the liability, enacts a rule of substantive law which operates in favor of the debtor in all legal relationships in which his continuing liability or cessation of liability becomes material. If the continuing tax liability of the John Barth Company was essential to the determination by the Commissioner of the amount of tax due and thus was a condition precedent to the accrual of a cause of action on the bond, then the extinguishment of the tax liability, by Section 1106 (a) of the Revenue Act of 1926, prior to the attempted determination by the Commissioner on March 25, 1926, of the amount of tax due from the John Barth Company, constitutes a complete defense to this action on the bond.

We call the court's attention to the case of *Edward P. Mertz, plaintiff vs. Andrew Mellon, Secretary of Treasury,*

decided by the Supreme Court of the District of Columbia on January 20, 1928, (reported in Prentice-Hall Federal Tax Service for 1928, page 309). There the court said:

> "The Act of Congress of February 26, 1926, is in the following language:
>
> "'the bar of the statute of limitations against the United States in respect of any Internal Revenue tax shall not only operate to bar the remedy, but shall extinguish the liability.'
>
> "It seems clear to the Court that this enactment wiped out completely the tax against the plaintiff for the year 1920, whatever the correct amount of that tax may have been, and this being so, the threatened destraint is intended to collect that which has no existence. It is not, it seems to the Court, an attempt merely to collect a tax alleged to be illegal, but it has no existence at all since the enactment of the Act of February 26, 1926."

It follows therefore both because of the limited right created under the Revenue Act of 1918 as set forth above and also from the express provisions of Section 1106 (a) that the "right" as well as the remedy has been extinguished by virtue of the limitation provisions of the Revenue Acts. Where the right or liability has become non-existent obviously there can be no remedy to establish or enforce it. There is no provision under the law giving the Commissioner the power to create a tax liability where it is non-existent or to revive a tax liability which has become extinguished. He cannot create liability by his fiat. As stated in the recent decision of *Joy Floral Co. vs. Commissioner of Internal Revenue*, 29, Fed. (2d) 865, in which a deficiency assessment of taxes accruing under the Revenue Act of 1918 was not made until July 15, 1925:

> "It therefore appears that under the Revenue Act of 1918, if considered alone, the instant assessment would be invalid; for that Act provided without qualification

that the amount of tax due under any return should be determined and assessed by the Commissioner within five years after the return was due or made. The powers of the Commissioner, it may be noted, are purely statutory, and must be construed accordingly."

The Government has strongly contended in its brief that the retroactive repeal of Section 1106 (a) has nullified its effect. The respondents believe that this repeal was without effect on this case and shall consider it in the following chapter.

CHAPTER III.

COMMENTS UPON THE CONTENTIONS SET FORTH IN THE BRIEF OF THE GOVERNMENT.

(a) *The Government has mistaken the issue.*

Chapters 1 and 2 of the Government's brief are written under a misapprehension of the issues in this case. As already set forth, the action on the bond is not barred by the limitation provisions of the Revenue Acts in the sense that a limitation period has run since the cause of action under the bond arose. As we have already shown, the effect of the limitations provisions of the Revenue Acts was to discharge the entire obligation on the bond and prevent a cause of action ever arising under it for the reason that the limitations provisions of the Revenue Act destroyed the liability for a tax and the bond was given to pay a "tax".

On pages 10-13 of its brief the petitioner elaborately demonstrates that where one of two remedies to protect a single right is barred, the other may still be enforced. This is admitted law, but, we submit, has no application here. The only right the petitioner had in this case under the

surety bond was to collect from the obligors on the bond the amount of the tax determined by the Commissioner to be due. If the Commissioner never made a valid determination, there can be no cause of action on the bond. Not only did the petitioner lose its remedies for the collection of a tax as a tax *per se*, but all collateral obligations measured by the tax, necessarily became extinguished with the primary obligation. In other words, the entire right became destroyed and therefore there can be no remedy to enforce it.

(b) *The Circuit Court of Appeals was correct in holding that the filing of the bond was not a waiver or tolling of the limitation provisions.*

1. *The Internal Revenue Bureau did not construe the filing of a claim in abatement as a waiver.*

The Commissioner was not stayed, either in determining or collecting the tax. Section 234 (a) (14) (a) provides that upon the filing of a bond, payment of the "amount of the tax covered by such claim shall not be required until the claim is decided," but there was nothing to prevent the immediate determination of the claim and the commencement of an action upon it. The Commissioner had the time of the determination, and hence of collection, completely within his control at all times. Moreover, he was forewarned by the Revenue Act that he had only a limited statutory period within which to make his determination.

The regulations of the Commissioner of Internal Revenue clearly disclose that the Internal Revenue Bureau did not feel that the effect of Section 234 (a) or 214 (a) is to compel any stay of the collection of the tax. We cite Regulations 45, Article 1632, pertaining to the duties of the Collector under the Revenue Act of 1918 providing as follows:

> "The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the

tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund."

Likewise the Board of Tax Appeals has held in a number of cases that the filing of a claim in abatement does not constitute a waiver of the statutes of limitations provided in the Revenue Acts.

Appeal of Ocean Accident and Guaranty Corp., 6 B. T. A. 1045;
Florence L. Klein vs. Commissioner, 6 B. T. A. 617;
Wirt, Franklin vs. Commissioner, 7 B. T. A. 636.

It is likewise held that the filing of a bond with a claim in abatement does not operate to suspend the statute of limitations.

Shaffer vs. Commissioner, 12 B. T. A. 298;
American Powder Mills vs. Commissioner, 12 B. T. A. 305;
Lieber vs. Commissioner, 13 B. T. A. 1175;
Anderson vs. Commissioner, 15 B. T. A. 475.

2. *The Commissioner was not stayed as to the determination and hence not as to the collection of the tax.*

Under any theory of the bond filed here the Commissioner at any time could have proceeded to his determination and hence to an action to collect the tax at his pleasure. He was benefited by getting additional security and his hand was not stayed as to determination or collection.

Obviously, the tax as assessed upon the filing of the original return, gave the Commissioner a complete cause of action to collect it. The filing of the bond only prevented him from pursuing the remedies of collection for a portion

of it unless he should first go through the prerequisite of determining the claim. The rule is established beyond all controversy that where a preliminary step within the control of the creditor must be taken before resort can be had to the remedy, the cause of action will be barred if both such preliminary step and the initiating of the suit are not commenced within the statutory period and nothing, that does not prevent the enforcement of the remedy by action, will toll the statute of limitations.

We cite the following authorities as being conclusive on this proposition:

Amy vs. City of Watertown, 130 U. S. 320; 32 L. Ed. 953, 955.

"But when a party knows that he has a cause of action, it is his own fault if he does not avail himself of those means which the law provides for prosecuting his claim, or instituting such proceedings as the law regards sufficient to preserve it."

Bauserman vs. Blunt, 147 U. S. 647, 37 L. Ed. 316, 320:

"In the absence of express statute or controlling adjudication to the contrary, two general rules are well settled. 1st. When the statute of limitations has once begun to run, its operation is not suspended by a subsequent disability to sue. *Walden vs. Gratz*, 14 U. S. 1, Wheat. 292 (4:94); *Mercer vs. Selden*, 42 U. S. 1 How. 37 (11:38); *Harris vs. McGovern*, 99 U. S. 161 (25:317); *McDonald vs. Hovey*, 110 U. S. 619 (28:269); 2nd. *The bar of the statute cannot be postponed by the failure of the creditor to avail himself of any means within his power to prosecute or to preserve his claim, Richards vs. Maryland Ins. Co.*, 12 U. S. 8 Cranch, 84 (3:496); *Braun vs. Sauereein*, 77 U. S. 10 Wall. 218 (19:895); *United States vs. Wiley*, 78 U. S. 11 Wall. 508, 513, 514 (20:211, 213); *Kirby vs. Lake Shore & M. S. R. Co.* 120 U. S. 130,

140 (30:569, 573); *Amy vs. Watertown*, 130 U. S. 320, 325 (32:953,956)." (Italics ours).

The requirement of determination as a prerequisite to the commencement of an action to collect taxes is analogous to the necessity of obtaining leave of a court to sue before an action may be commenced. In the following case the Supreme Court of Minnesota said with reference to an action on an official bond:

> "His cause of action (if any he has) accrues independent of and prior to the application for leave, and is the very basis upon which the application rests; and hence a statute of limitations commencing to run from the date when his cause of action accrues, commences to run from the same time that it would commence if no such leave were required; that is to say, in a case like this at bar the statute commences to run from the time when the wrong complained of was done, and not from the time of obtaining leave to sue.
>
> * * * but to allow a party to extend the time within which he will bring his action upon an official bond against sureties as well as the principal, indefinitely, by postponing his application for leave to sue, is not only anomalous, but so contrary to the entire spirit, policy and purpose of statutes of limitation, and so impolitic in itself, that the question mentioned is one of very great practical and substantial importance, and there is no sensible reason why the obtaining of leave to sue, and the institution of the action should not both take place within the period limited for the bringing of the action."
>
> (Litchfield vs. McDonald, 35 Minn. 167, 28 N. W. 191.)

See also: *Wenton vs. Jones*, 160 Minn. 32, 199 N. W. 431; *Bogart vs. George K. Porter Co.*, 193 Cal. 197, 223 Pac. 959; *People vs. McGee*, 41 Cal. App. 727, 183 Pac. 289.

3. *Section 250 (d) and Section 234 (a) (14) (a) do not require a construction extending the statutory period.*

The filing of the claim in abatement and the bond required the Commissioner for the first time to exercise his powers of determination. Prior to that there was no controversy and no issue to be determined (see supra Chap. I). It did not extend the time for "determination". On the contrary, it brought into operation the part of Section 250 (d) limiting the determination to the period of five years after the return was made.

The Government has argued in its brief, (see pages 28 and 29) that the clear intent of Section 234 (a) (14) (a) was to substitute a bond free from any running of the statute of limitations as to so much of the tax as was covered by any undertaking given in pursuance to such section. We would first point out that there is no such express language in the section. If such a general and important result were intended, it would seem that the statute would have said so in fairly specific language.

The filing of the bond did not postpone the time within which the Commissioner was required by Section 250 (d) to "determine" the tax or in which a suit or proceeding for the collection of the tax should be begun since it did not constitute a "consent in writing" by both the Commissioner and the taxpayer to a later determination or collection of the tax.

Section 250 (d) of the Revenue Act of 1921 provides:

> "The amount of income, excess profits or war profits taxes * * * due under any return made under this act for prior taxable years or under prior income, excess profits or war profits tax act * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment and collection of the tax, and no suit or proceeding for the collection of any such taxes due * * * under prior income, excess profits or war profits tax acts * * * shall be begun

after the expiration of five years after the date when such return was filed."

This statutory provision provides the method of postponing the time in which determination, assessment and collection of the tax may be effected, and that is by a consent in writing of both the Commissioner and the taxpayer.

Under the principle of "*expressio unius est exclusio alterius*" which Mr. Justice Baldwin in *U. S. vs. Arredondo*, 6 Pet. 725; 8 U. S. (L. Ed.) 547, 560, described as "a universal maxim in the construction of statutes," it is a general principle of interpretation that the mention of one thing implies the exclusion of all others. This principle is certainly applicable to revenue laws which are "to be interpreted liberally in favor of the taxpayers."

Bowers vs. N. Y. & Albany Lighterage Co., 273 U. S. 346; 47 Sup. Ct. 389; 71 L. Ed. 676.
Gould vs. Gould, 245 U. S. 151, 62 L. Ed. 211.
Merriam vs. U. S., 263 U. S. 179, 68 L. Ed. 240.

It seems significant to us that the petitioner in its brief does not dispute the correctness of the Circuit Court of Appeals decision in holding that because Section 250 (d) provides an express method for waiving or tolling the limitations provisions of the statute an implied waiver cannot be read out of Section 234 (a) in view of established principles of statutory construction. (R. 18-19).

The filing of the bond and the claim for abatement did not constitute a consent in writing by both the Commissioner and the taxpayer, to postpone the time within which the Government was required to determine, assess and collect the tax. Consequently it operated to postpone neither the time for the determination of the tax, nor its collection.

Section 234 (a) (14) (a) is followed by the administrative

provisions of the Revenue Act as to enforcement and collection of tax liability, among them being Section 250 (d) restricting the assessment, determination and collection of taxes to a five-year period. It follows, therefore, that Section 250 (d), by accepted rules of statutory construction, was intended to apply to taxes coming under the provisions of Section 234 (a) (14) (a) just as it applies to the other substantive provisions of the Revenue Act.

The hand of the Commissioner under the statute was not stayed. The claim in abatement could be filed, the claim determined and rejected, and the action commenced all on the same day. It seems, then, a very sweeping assumption to claim that in a situation such as this, where the Commissioner can at any time perform the prerequisite to bringing his action, the statutes should be construed, nevertheless, to give him an unlimited time within which to perform such prerequisite.

A bond filed in connection with a return asking for a determination of the correct statutory tax under the provisions of 234 (a) is not intended, to our mind, to protect the Government *beyond* the statutory period of limitations nor impliedly to waive the limitation provision protecting the taxpayer. Is it not much more reasonable to suppose that the sole purpose of requiring a bond is to protect the Government *during* the statutory period of limitations? We doubt very much whether any surety company, if it had been confronted with the present contention of the petitioner that all statutes of limitations governing taxes are abrogated by the filing of such a bond and that the Commissioner may retain and consider such a claim indefinitely, would ever have entered into such a surety contract.

4. *The filing of the second claim in abatement after the running of the statute of limitations was ineffectual.*

It is contended by the Government on pages 29-30 of its brief that the fact that the respondents filed a second claim in abatement after the running of the statute of limitations on March 17, 1925, is pertinent to this case. It is respectfully submitted that this filing of the second claim in abatement was ineffectual and does not vary the rights of the parties in this action.

In the recent decision in *Joy Floral Co. vs. Commissioner of Internal Revenue*, 29 Fed. (2d) 865, it was held that even an express consent to the extension of time for assessment made after the lapse of the 5-year period of limitation was ineffective to revive the Commissioner's authority to make an assessment after the bar of the statute had intervened.

See also *Walsh vs. Price*, (E. D. of N. Y.) November 20, 1928, Reported C. C. H. 1929 Vol. III, p. 8072.

(c) *The cases cited by the Government are distinguishable.*

Several cases are discussed in the Government's brief, pages 17-27, on the theory that they are applicable to the present case. With the exception of the decision in the case of *United States vs. Reynolds*, 27 Fed. (2d) 902, each of the cases is distinguishable for the reason that the determination of the Commissioner was made prior to the running of the statute of limitations.

In the case of *United States vs. Ouken Bros. Company, Inc.* 23 Fed. (2d), (Wyo.) 367, it appears that a claim for abatement and a bond were filed with respect to an additional assessment of income tax for the year 1918. The Commissioner of Internal Revenue rejected the claim for abatement in June, 1923. Inasmuch as the return for the year 1918 would normally be filed on or before March 15, 1919, it clearly appears

that the determination by the Commissioner was made *before* the five year statutory period of limitations had elapsed, and thus the *Onken* case vitally differs from the instant case, in which the Commissioner purported to determine a tax *after* all tax liability had been extinguished by the running of the period of limitation prescribed by the Revenue Acts.

In the case of *McCaughn vs. Philadelphia Barge Co.* 27 Fed. (2d), (E. D. of Pa.) 628, the Commissioner of Internal Revenue in October, 1920, made an additional assessment against the taxpayer on account of its 1918 income. The taxpayer filed a claim for abatement and the bond on which suit was brought. It appears that on May 14, 1923, the Commissioner of Internal Revenue rejected the defendant's claim for abatement and found the additional tax to be correct. Here again we find that the Commissioner of Internal Revenue made his determination of the tax due *within* the statutory period prescribed by the Revenue Acts, thus clearly distinguishing the case from the instant one.

In the case of *United States vs. Reynolds*, 27 Fed. (2d) 902, it appears that the income tax return in question was filed on March 1, 1918, and that a claim for abatement and a bond were filed in April, 1922. On November 8, 1923, the Commissioner of Internal Revenue rejected the claim for abatement and demanded payment of the tax. The Commissioner purported to determine a tax to be due after the lapse of the statutory period of limitation prescribed by the Revenue Acts. The defendant, however, does not appear to have raised the point that the Commissioner was without power to make a valid determination of a tax after all tax liability had been extinguished. The case would thus appear to decide only that the statutory period of limitation prescribed by the Revenue Acts for the existence of tax liability and the remedies for collection of taxes do not apply to bar the enforcement of a cause of action which has attached

under a bond. Moreover, the *Rennolds* case is distinguished from the instant case in two respects: In the first place, the bond was not one filed under Section 234 (a) (14) (a) which contemplates that the bond be filed with the original return or at least prior to the fourth quarterly payment of the tax. In the second place, in the *Rennolds* case the determination by the Commissioner of the claim in abatement and hence the amount due under the bond was made more than two years before the passage of Section 1106 (a) of the Revenue Act of 1926. Hence in the *Rennolds* case it might fairly be argued that although the remedy for the collection of the tax was barred, the tax liability was not extinguished at the time of the determination. In the instant case, however, a determination was made after the enactment of Section 1106 (a) of the Revenue Act of 1926 and hence clearly after the tax had been extinguished as effectually as if it had been paid.

Furthermore, a hypothetical case put by the learned District Judge shows conclusively that he did not have in mind a situation such as is presented by the bond in this case. The case put was:

> "Could it be contended that, if C should undertake in writing to A that he (C) would pay A for all merchandise sold on open account to B, and A thereafter should sell B such merchandise, but fail to collect from B within a 5 year statutory limitation upon open accounts, he could not recover from C upon the latter's written contract within a 10 year statutory limitation period? The negative answer is obvious."

We concur in the learned Judge's answer to his own question, but in the present case an analogous proposition would be involved if C should undertake in writing to A that he (C) would pay A what might be due A from B for merchandise sold on open account. In this case if B's debt to A was extinguished, whether by payment or by a statute of limitations

extinguishing the right as well as the remedy surely the learned District Judge would not have contended that C would be liable to A upon his written undertaking. The decision in the *Reynolds* case shows clearly that the court in its decision entirely overlooked the distinction discussed by Professor Williston and set forth on page 8 of this brief.

In the case of *United States vs. United States Fidelity & Guaranty Co.*, 221 Fed. 27, it was never disputed but that there was a breach of the bond when the principal removed a large quantity of spirits without payment of the tax after giving a bond conditioned that "he shall in all respects faithfully comply with all the provisions of law relating to the duties and business of distillers."

That case is obviously distinguishable from the instant case in which the basic question at issue is whether there can be a cause of action on the bond where the primary obligation has been extinguished by the running of the period of limitations. The same comment applies to the case of *Raymond vs. United States, Fed. Case* 11596.

(d) *The petitioner's brief is unsound in attempting to construe Section* 234 (a) *and* 250 (d) *of the Revenue Act of* 1918 *by considering statutes enacted by Congresses* 8 *and* 10 *years later.*

On pages 35 to 38 of its brief the petitioner asks the court to construe Sections 234 (a) and 250 (d) of the Revenue Act of 1918 by assuming that the legislative purpose expressed in 283 (l) of the Revenue Act of 1926 and in Section 607 and 611 of the Revenue Act of 1928, was expressive of the intent of the Congress of 1918. It is plain that the sections in question do not purport to be retroactive except as stated therein and that they are not directions to a court to guide construction and do not purport to be. Moreover, the particular statutes relied on were definite modifications of

the revenue acts. If all subsequent modifications and revisions of the revenue acts are to be construed as providing a sort of common law for the construction of a particular earlier revenue act, then indeed we have embarked on an uncharted sea. It does considerable violence to common knowledge to assume that what moved Congress in 1928 was the same thought or idea which impelled Congressional action in 1918. In any event this court has disposed of a contention so contrary to fact in *Russell vs. United States*, 278 U. S. 181, 49 S. Ct. Rep. 121, 123, in which it held that:

> "The legislative history of the act of 1924 lends support to the conclusion which we have reached. The changes introduced into the act of 1926 cannot authorize construction of the earlier one not consonant with the language there employed."

See also *U. S. vs. Gillis*, 95 U. S. 407, 24 L. ed. 503.

(e) *The principle that the United States is not to be bound by a statute of limitations unless such intention is clearly manifested is not applicable here.*

A persistent argument of the petitioner seems to be that because the Circuit Court of Appeals stated that the application of the statutes of limitation was a question not devoid of difficulty, it erred in not applying the principle that in cases of uncertainty or ambiguity, statutes of limitations should be construed in favor of the government. (See pages 11, 14 and 29 of brief). For this proposition the petitioner cites, among other cases, *Bowers vs. N. Y. Lighterage Co.*, 273 U. S. 346, 349, 47 S. Ct. 389, 71 L. ed. 676. We submit that this contention of petitioner is entirely erroneous. It is, of course, established law that where there is a general statute of limitations, it will not be construed as having been intended to apply to the United States unless such intention is manifest in its language. Here, however, we have an en-

tirely different situation. The limitation provisions contained in the Revenue Acts of the United States are obviously intended to apply to the United States. Moreover, it is clear that where we are dealing with limitation provisions contained in Revenue Acts that such provisions as part of taxing statutes will be interpreted liberally in favor of the taxpayer. Indeed, the very case cited so often by the Government, (the Bowers case referred to above), holds exactly this when it says:

> "The provision is part of a taxing statute and such laws are to be interpreted liberally in favor of the tax payers."

(f) *The retroactive repeal of Section 1106 (a) of the Revenue Act of 1926 does not affect this action.*

Section 612 of the Revenue Act of 1928 provides:

> "Section 1106 (a) of the Revenue Act of 1926 is repealed as of February 26, 1926."

It is the contention of the respondents that the repeal of Section 1106 (a) as of the date of its enactment cannot deprive them of rights already vested pursuant to Section 1106 (a). The Circuit Court of Appeals upon motion of the Government for rehearing sustained the contention of the respondents herein on this point (R. 21) and cited the recent decision of this court in *William Danzer & Co. vs. Gulf & Ship Island R. R. Co.* 268 U. S. 633, 69 L. Ed 1126. This court held in that case that if Congress by the Transportation Act of 1920, wherein they excluded from the running of the statute of limitations the period of Federal control, had thereby authorized an action previously barred by the statute of limitations then:

> "To give it (the statute) that effect would be to deprive defendant of its property without due process of law in contravention of the Fifth Amendment."

It is respectfully submitted that the Danzer case is controlling authority that the repeal of Section 1106 (a) deprives the respondents of their property without due process of law if construed to revive a right or liability previously extinguished.

In addition to the decision of the Circuit Court of Appeals for the Seventh Circuit in this case, two Federal Courts have recently held that Section 612 of the Revenue Act of 1928 cannot deprive taxpayers of any rights vested in them under the provisions of Section 1106 (a) of the Revenue Act of 1926.

> *Gile vs. Huntley*, 29 Fed. (2d) 209,
> *Dobbins vs. Commissioner*, C. C. A. 3rd Cir., Mar. 7, 1929, reported Prentice Hall Tax Service for 1929, Par. 603.

In this latter case the Court made the following statement:

> "Section 1106 of the Act of 1926 provides that the bar of limitations against the United States in respect of any internal revenue tax shall not only operate to bar the remedy, but shall extinguish the liability. Therefore, if the United States did have a just claim against Emily M. Dobbins in respect of any tax before the statute ran against it, *the liability was absolutely extinguished in 1926* when the United States was seeking to recover it *and the repeal of the section by the Act of 1928 did not revive a dead liability or create a new obligation.*" (Italics supplied).

The cases cited by the Government relative to the power of Congress to ratify taxes illegally collected are not applicable. The cases cited by the Government are cases where a liability for taxes never theretofore existing, was created under the power of Congress retroactively to enact tax legislation. None of the cases involve a tax or other liability which had been created, subsequently extinguished, and then recreated

by retroactive legislation. No case has been cited where the constitutionality of a statute recreating a liability *under contract* was sustained where the liability under the contract had once been extinguished.

When the taxpayer's liability for taxes was once discharged by virtue of Section 1106 (a), the entire obligation on the bond ceased and the bond became utterly void. How can Congress by reinstating a tax liability against a taxpayer create a new bond liability for such tax retroactively imposed by a new statute? The bond was given to secure a tax imposed by a specific section of the Revenue Act of 1918 and not for any tax for 1918 by whatever act imposed. Any new tax imposed by Section 612 is entirely outside the terms of the bond and hence immaterial to this case.

We do not desire to protract the argument on this phase of the case beyond stating that it certainly would be absurd to contend that a taxpayer's 1918 taxes might be considered paid or extinguished in 1926 by virtue of a particular statute, unpaid and still owing in 1928 by virtue of another, and be alternately extinguished or owing every two years thereafter as Congress passed retroactive legislation.

However, we do not think that this constitutional question is presented to the court for determination. As demonstrated earlier in this brief, Section 1106 (a) is only declaratory of the effect of the limitation provisions of Section 250 (d) of the Revenue Act of 1918. The repeal of Section 1106 (a) did not purport to affect the Revenue Act of 1918 and when the tax liability created by it expired by virtue of its limitation, it remains extinguished regardless of the repeal of Section 1106 (a).

(g) *The petitioner has completely eliminated the word "determination" from Section 250 (d) of the Revenue Acts of 1918 and 1921.*

A clear instance of this is found in the Government's brief at page 17, reading as follows:

> "The statutes relied upon by the respondents place a limitation only upon the time within which the United States may commence a proceeding for the collection of taxes."

Another instance to which we invite the courts' attention is found at the top of page 29 where the petitioner says:

> "We have a contract to pay the amount ultimately to be determined to be due when the determination is made regardless of statutes of limitation on assessments or suits to collect taxes, the benefits of which were waived by the obligors of the bond."

The above statements illustrate the fundamental fallacy of the petitioner in ignoring the comprehensive scope of Section 250 (d).

Section 250 (d) does not only contain the clause,

> "* * * no suit or proceeding for the collection of any such taxes due under * * * prior income * * * tax Acts * * *, shall be begun after the expiration of five years after the date when such return was filed * * *,"

but also provides that:

> "* * * the amount of any such taxes due under any return made under * * * prior income * * * tax Acts * * * shall be determined and assessed within five years after the return was filed."

We thus have a five year limitation against each of the following.

a. The determination of a tax.
b. The assessment of a tax.
c. The commencement of any suit.
d. The commencement of any proceeding.

It seems apparent that Congress intended that all determinations, all assessments, all suits and all proceedings to be effective must be had or initiated within five years after the date of the return.

CONCLUSION.

The entire case of the Government rests on the validity of the determination of the claim in abatement which was admittedly made two years after the five year limitation period had run. We submit that the entire case falls because under the Revenue Acts the determination was void and hence there was no cause of action on the bond.

In view of the foregoing, we respectfully submit that the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

LOUIS QUARLES,
MALCOLM K. WHYTE,
S. SIDNEY STEIN,
RICHARD S. DOYLE,
Attorneys for Respondents.